South African Institute of Tax Professionals

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The South African Revenue Service

Lehae La SARS, 299 Bronkhorst Street

PRETORIA

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BY EMAIL: policycomments@sars.gov.za

RE: DRAFT INTERPRETATION NOTE: SECTION 10(1)(gC)(ii) EXEMPTION – FOREIGN PENSIONS AND TRANSFERS

We write to comment on the draft interpretation note on the section 10(1)(gC)(ii) exemption in respect of a lump sum, pension or annuity received by or accrued to any resident from a source outside the Republic, and in respect of amounts transferred from a source outside the Republic into a local retirement fund.

A. Background

Section 10(1)(gC)(ii) exempts from normal tax any lump sum, pension or annuity received or accrued to any resident from a source outside the Republic as consideration for past employment outside the Republic. This exemption does not apply to an amount paid from any local retirement fund, except if such amount was transferred to that local retirement fund from a source outside the Republic. The draft interpretation note provides clarity on the interpretation and application of the phrase "from a source outside the Republic". We request that further clarity be provided regarding the interpretation: (i) in terms of amounts received from foreign lump sums, foreign pensions and foreign annuities, and (ii) in terms of the application of the phrase "any amount transferred to that fund".

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B. Comments for consideration - Foreign lump sums, pension funds and annuities

The interpretation note needs to clarify that amounts stemming from foreign lump sums, pension funds and annuities need not be from regulation foreign pension funds in a South African sense. The funds must merely be from employer-provided retirement set-asides initially associated with foreign service income. Retirement savings comes in many forms – not just from regulated entities in a South African sense. Foreign countries have different systems, many of whom do not have a formal system of allowing contribution deductions, exempt build-ups and especially special rules for lump sum pay-outs. These rules not only differ in a tax sense but many less developed countries simply do not have widespread regulated private pensions systems that are regulated by agencies such as the Financial Services Board.

A literal review of the legislation is fully in line with this interpretation. The words from a lump sum, pension fund and annuities is fairly open-ended. There is no suggestion that these amounts must be closely akin to South African funds that would be exempt under section 10 or subject to the special lump sum pay-out rules associated with the Second Schedule. Most notably, unregulated funds pose no tax risk because these amounts were fully subject to tax when initially earned and further subject to tax in terms of subsequent accruals.

C. Comments for consideration – Amounts transferred from foreign funds

The interpretation of the exemption for amounts paid by a local retirement fund following a <u>once-off foreign fund transfer</u> is clearly demonstrated in Example 2 under point 4.2. In the example, the full value in the foreign fund was transferred to the local retirement fund at the stage when the employee returned to work in South Africa. The scenario where there is a <u>monthly transfer of contributions</u> from a foreign employer to a local retirement fund is not dealt with in the draft interpretation note. We suggest that the interpretation note should also deal with this scenario. We submit that monthly contributions are "amounts transferred" as envisaged in the exemption even if not from a regulated foreign pension fund in a South African sense. Transfers stemming from formal and informal retirement savings should be sufficient. Our detailed analysis in this regard is set out in the **Annexure**.

From a practical perspective, we further request that the interpretation note provides guidance to local retirement funds on how the exempt portion of amounts paid by the local retirement fund should be determined in this scenario, dealing both with a defined benefit and a defined contribution fund. We understand that there is currently a lot of uncertainty in this regard as retirement funds are not willing to provide letters confirming the amount of the contributions paid from offshore. In turn, SARS are not willing to issue hardship directives without such confirmation letters. In the case of a defined benefit fund particularly, the question is whether the contributions relating to an employee should perhaps be determined with reference to a formula. The formula contained in paragraph 12(D)(3) of the Seventh Schedule to value the fringe benefit on employer retirement contributions could perhaps be used as a reference point.

We welcome the opportunity to comment on the draft guide and look forward to future engagements.

Yours sincerely

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ANNEXURE

EXEMPTION – FOREIGN PENSIONS AND TRANSFERS: ANALYSIS REGARDING MONTHLY CONTRIBUTIONS BY FOREIGN EMPLOYERS TO LOCAL RETIREMENT FUNDS

1. INTRODUCTION

1.1 The draft Interpretation Note ("**the Interpretation Note**") clarifies the interpretation and application of section 10(1)(gC)(ii) in relation to the meaning of the word "source", which appears twice in the section.

1.2 We submit that the Interpretation Note should also deal with the interpretation of the word "transferred", contained in the phrase:

> "… *excluding any amount transferred to that fund from a source outside the Republic in respect of that member*" ("**the Proviso**").

2. THE ISSUE

2.1 South African multi-nationals seeking to expand into Africa will often second an employee to a subsidiary company in Africa ("**African Subsidiary**") on a long-term secondment contract, such that the employee ceases to be resident in South Africa ("**the Seconded Employee**")[1].

2.2 In the majority of cases, the employer would not wish to set up a local pension scheme in the foreign country for, *inter alia*, the following reasons:

2.2.1 in the start-up phase, the cost of a local pension fund for a small number of employees would not be justifiable;

2.2.2 the economic and political environment in the country may be such that the employees do not wish to have their pension contributions paid into a local fund;

2.2.3 until the presence in the foreign country is substantial, the "economies of scale" needed in order to make a pension fund function properly, will not be achievable.

2.3 In these circumstances, what normally happens is that the African Subsidiary makes monthly payments to the group pension fund based in South Africa ("**SA Group Pension Fund**") on behalf of the Seconded Employee i.e. not by way of a lump sum transfer at the end of the contract, but by way of monthly payments.

2.4 From the perspective of the country in which the Seconded Employee is based ("**the Foreign Country**"), because the payments are not made to a local pension fund, the payment to the SA Group Pension scheme is included in the local income of the Seconded Employee and he pays local tax thereon i.e. the employee pays tax on the amounts contributed to the SA Group Pension Fund.

[1] Such secondments are not limited to Africa, but the departure point of this memorandum is that South Africa should be a "platform into Africa".

2.5 If the employee then returns to South Africa and reassumes tax residence there and, having retired, receives payments from the SA Group Pension Fund, then the question is whether or not the payments that have been made by the African Subsidiary to the SA Group Pension Fund should be regarded as amounts "transferred to that fund from a source outside the Republic in respect of that member".

2.6 In particular, the issue is whether or not the word "transferred" should be interpreted narrowly to mean only a transfer of funds from a foreign pension fund to a SA pension fund ("**the narrow interpretation**") or whether it should be interpreted to mean the transfer of any amount, including regular payments by the African Subsidiary to the SA Group Pension Fund ("**the wider interpretation**")? In other words, is it a requirement for the Proviso to apply that the funds are first accumulated in the Foreign Country in a local pension fund before being transferred to the SA Group Pension Fund?

3. ANALYSIS

3.1 Rules of interpretation

It is trite law that tax legislation must be interpreted in accordance with its ordinary grammatical meaning, unless this would lead to absurdities or anomalies, or would otherwise not achieve the scope and purpose of the legislation.

3.2 Ordinary meaning

3.2.1 The word "transfer" in the current context, means:

"*the movement of an amount from one place or person to another*"[2];

3.2.2 In the scenario postulated above, the pension contributions move from the African Subsidiary to the SA Group Pension Fund. This is a "transfer" (and, in terms of the existing draft Interpretation Note, is from a source outside South Africa). As there is no ambiguity or anomaly, then as a matter of statutory interpretation, the words "from a foreign pension fund", cannot be read into the Proviso.

3.2.3 Nor can it be argued that the word "transfer" does not include a "contribution". A contribution means, in the current context:

"*to give a part to a common fund*"[3] A transfer to a pension fund is synonymous.

3.2.4 The use of the words "*any amounts*" as opposed to "*an amount* "reinforces the position that transfers do not have to be made in a lump sum.

3.3 Scope and Purpose of the Legislation

3.3.1 The mischief at which the amendment to section 10(1)(gC)(ii) was aimed can be discerned from the Explanatory Memorandum to the amendment.

[2] Merriam-Webster
[3] Op.cit.

3.3.2 The Explanatory Memorandum states that South African residents who work outside South Africa could get a tax deduction on contributions made to the South African pension fund in South Africa, but then, under section 10(1)(gC)(ii), as it then read, would not be subject to tax on receipt of the pension payments – in other words, double non-taxation.

3.3.3 To ensure a fair tax treatment of retirement benefits received by South African residents, the amendment to the section was made.

3.3.4 In the scenario postulated above, there would be no deduction of the pension payments for South African tax purposes. On the contrary, the pension payments are likely to be included in the income of the Seconded Employee in the Foreign Country in which he is resident (see paragraph 2.4 above).

3.3.5 It follows that the mischief at which the amendment was aimed would not be present in the scenario postulated above.

4. PRACTICAL IMPLICATIONS

4.1 If the narrower interpretation were adopted, then South African multi-nationals would have to do the following in order to act in the best interests of their expatriate employees:

4.1.1 set up a local pension scheme in each Foreign Country in which they operate, despite the factors set out in paragraph 2.2 above; or

4.1.2 set up an international pension scheme outside South Africa, despite the fact that there may be insufficient employees to justify the cost of such a scheme.

4.2 The narrower interpretation would also:

4.2.1 discourage international groups from using South Africa as a platform into Africa;

4.2.2 impose additional cost burdens on South African companies wishing to expand into Africa.

5. CONCLUSION

We would submit that the wider interpretation is the correct interpretation of the Proviso for the reasons set out above, and that the Interpretation Note should deal with this issue in addition to the "source" issue.